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TREASURY FOR INTERNATIONAL AFFAIRS - JROSE AND MNUGENT

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SUBJECT: IN A POLITICAL YEAR, TURKEY STICKS WITH IMF

REF: A. ANKARA 6052

[1](#)B. ANKARA 6403

Classified By: Economic Counselor Tom Goldberger for reasons 1.4(b) and (d).

[1](#)1. (SBU) Summary. The Turkish Government has re-committed to the IMF program despite having to swallow a fifth straight dose of fiscal austerity in advance of next year's elections.

Before recommending that its Executive Board approve a new \$928 million disbursement -- hopefully before the crucial December 15 EU Summit -- IMF staff wants to see details of budget safeguards that will keep health spending under control and a commitment to increase prices paid by consumers for natural gas and electricity. The AK Party government's readiness to continue its IMF program in a tough election season suggests the importance of the IMF program to the AKP's overall economic success story, as well as the desire to have at least one of the economy's two economic policy "anchors" in place should the EU accession process fall apart. End Summary.

The Big Picture -- Committed to Program Despite Elections

[1](#)2. (C) The IMF mission that left Ankara in late October just barely reached an agreement on the conditions for releasing a new tranche. IMF staff told us they clearly sensed a new, election-year negotiating mentality on the part of the government, which opened the talks with a gambit to loosen the 6.5% of GDP target for the primary fiscal surplus, which is the keystone of the program. In the end, however, rather than break with the IMF now to allow election-year flexibility, the Government accepted the Fund's rigidity on the fiscal targets and agreed to additional measures as well.

According to a Turkish Treasury official, the May-June market turmoil played a significant role in demonstrating to the GOT the economy's vulnerability to market sentiment. The possibility of trouble with Turkey's EU anchor also concentrated minds: Minister Babacan is keen to get an IMF board vote before the December 15 EU Council meeting that could decide the fate of Turkey's EU accession bid.

Fiscal Austerity Needed for Markets, Current Account Deficit

[1](#)3. (SBU) The IMF continues to hang tough on fiscal austerity because it believes global financial markets will allow Turkey no room for mistakes, particularly given Turkey's upcoming election year, EU accession difficulties,

and large current account deficit that makes any emerging market sell-off hit Turkey extra hard. The IMF now expects the current account deficit to come in at about 8% of GDP, higher than analysts were predicting even a couple of weeks ago. On November 6, the September current account deficit numbers came in substantially worse than expectations at \$1.9 billion, in part because of lower tourism revenues. For the first nine months of the year, the deficit reached \$25.3 billion, up from \$15.8 billion last year.

Controlling Health and Energy Spending

¶4. (SBU) In addition to budget measures for 2006 equivalent to 0.2% of GDP, the IMF wants to see stronger commitments from the GOT in two key areas, health spending and energy prices, before recommending Executive Board approval of the next tranche. The staff feels that they will receive such an assurance in the form of a measure that gives the Social Security Institution authority to raise health insurance co-payments without seeking further government authorization. The IMF is also seeking increases in administered gas and electricity prices, which have an impact on the overall public sector primary surplus because gas and electricity companies are still owned by the state (see ref b). The IMF Mission secured Minister of Economy Babacan's agreement on electricity and gas price increases. At the AK Party Congress November 11, Prime Minister Erdogan publicly indicated electricity prices might go up by at least 5%, suggesting he has blessed the price increases despite his previous public opposition.

Comment

¶5. (C) The IMF rep told us that if Turkey were going to break with the Fund program, it would have done so during these negotiations. The fact that it has gone ahead and apparently accepted the hot button healthcare and energy measures may reflect a judgment that it easier to do so now, several months before the presidential election rather than wait for a day of reckoning closer to the elections. The May-June volatility and Turkey's rocky EU accession process seem to be key drivers, but the Government also seems to see the success of its IMF program as part of its broader track record of economic success and good relations with the West. Economy Minister Babacan told a recent U.S. business delegation led by General Scowcroft that the AKP's management of the economy was its strongest electoral car, and that it would do nothing to endanger that reputation.

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